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No. 836

In the Supreme Court of the United States

OCTOBER TERM, 1964

THE BOEING COMPANY, a Delaware corporation, *Petitioner*,

vs.

THE UNITED STATES OF AMERICA, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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FRANK PRINTING COMPANY — SEATTLE, WASHINGTON

No.

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No.

In the Supreme Court of the United States

OCTOBER TERM, 1964

THE BOEING COMPANY, a Delaware corporation, *Petitioner*,

vs.

THE UNITED STATES OF AMERICA, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

The Boeing Company prays that a writ of certiorari issue to review the judgment of the United States Court of Claims entered in the above entitled case on November 13, 1964.

CITATION TO OPINION BELOW

The opinion of the Court of Claims (R. Vol. 1, pp. 45-80), printed in Appendix A hereto, *infra*, pp. 11-36, is reported at 338 F.2d 342.

JURISDICTION

The judgment of the Court of Claims was entered on November 13, 1964 (R. Vol. 1, p. 45). Jurisdiction of this Court is invoked under 28 U.S.C. § 1255(1).

QUESTION PRESENTED

Petitioner's tax liability under the Excess Profits Tax Act of 1950 (64 Stat. 1137) is dependent upon the amount of its "total assets" on the last day of each of the years 1946-1949, inclusive. During those years petitioner had fixed-price contracts with the United States for the manufacture and sale of military aircraft. On the four critical dates petitioner had on hand inventories of property accumulated under these contracts, such as raw materials, parts, components and partially completed aircraft. The cost of these inventories was properly included in petitioner's total assets.

These contracts contained the "progress payments" clause customarily to be found in fixed-price Government contracts, the form of which has been before this Court in *City of Detroit v. Murray Corp.*, 355 U.S. 489 (1958). This clause authorizes the making of progress payments measured by costs previously incurred under the contract, and provides for the passage of title to inventories and like property on hand or subsequently acquired.

The question presented is whether, in computing total assets, there should be deducted from the inventories accumulated under fixed-price Government contracts the amount of the progress payments received. The answer depends on these subsidiary questions:

Are progress payments made and received as part payments of an agreed purchase price incident to a concurrent sale of inventories, or are they a mere financing device,

substantially equivalent to a loan giving rise to a liability and having no effect on total assets? Did the parties to these contracts intend there to be a purchase and sale of bits and pieces of airplanes, or only a sale of completed, operational aircraft following delivery and acceptance? The Court of Claims held that a sale of inventories was intended to and did occur, contrary to the Seventh Circuit's decision in *Consolidated-Hammer Dry Plate & Film Co. v. Commissioner*, 317 F.2d 829 (7th Cir. 1963), and to *American Motors Corp. v. City of Kenosha*, 356 U.S. 21, reh. denied 357 U.S. 912 (1958), affirming per curiam the Wisconsin Supreme Court decision reported at 274 Wis. 315, 80 N.W. 2d 363 (1957).

STATUTES INVOLVED

The statutory provisions involved are Sections 442(f) and 446 of the Internal Revenue Code of 1939, as amended, 26 U.S.C. (1952 ed.) §§ 442(f) and 446. They are reproduced in Appendix B, *infra*, pp. 55-57, together with those portions of Treasury Reg. 130, Sec. 40.446-3 (c) and Sec. 40.442-3(d)(1) (1951), making the definition of "total assets" in 26 U.S.C. 442(f) applicable to this case.

STATEMENT

This case involves the amount of petitioner's excess profits credit under the Excess Profits Tax Act of 1950. Petitioner computed its credit under Section 446 of the 1939 Code by using the average of its total assets on the four critical dates of December 31, 1946-1949, inclusive (Finding 19, App. A, *infra*, p. 52).[1] The sole issue in the

[1] The findings of fact by the Trial Commissioner were adopted by the Court of Claims and are set forth at pages 37 through 54 of Appendix A, *infra*, and pages 22 through 36 of Vol. 1 of the Record. Hereinafter references to such findings will cite only the appropriate page of Appendix A.

case relates to the amount of total assets on the four critical dates.

During each of the four years petitioner had certain fixed-price contracts with the United States providing for the production and sale of military aircraft (App. 37). Petitioner expended money and accumulated charges in the performance of these contracts, and carried such expenditures and charges on its books of account as work-in-process inventory until an aircraft or other article was delivered to and accepted by the Government (App. 41, 47). Consequently, on each of the four critical dates petitioner's total assets included a work-in-process inventory representing expenditures and charges accumulated on the undelivered portion of fixed-price Government contracts (App. 52).

Each of these fixed-price contracts contained a typical progress payments clause (App. 39), pursuant to which petitioner received certain amounts from the Government.

In its 1951 tax return, in computing the amount of its total assets, petitioner failed to include therein the full amount of the expenditures and accumulated charges on fixed-price Government contracts. Instead, it subtracted therefrom the amount of progress payments received under such contracts (App. 53). The consequence was to reduce petitioner's total assets and therefore its excess profits credit, and increase its tax liability by $913,804.64 (App. 14, 15).

Petitioner brought suit in the United States Court of Claims to recover this overpayment (App. 14). The jurisdiction of the Court of Claims was based upon 26 U.S.C. § 1491. On November 13, 1964, the Court of Claims entered its judgment adopting, with minor modifications, the findings and opinion of the Commissioner, and dismissing the petition (App. 11). The Court of Claims placed principal reliance on the title-passing provision of the

progress payments clause, and on authorities holding that the title so passing to the Government is sufficiently substantial to insulate the property from local taxation and the claims of creditors of the contractor; and concluded, on the basis of these authorities, that a purchase and sale of inventories was intended so that the progress payments should be subtracted from the work-in-process inventories. The Court of Claims expressed disagreement with the Seventh Circuit which, in *Consolidated-Hammer Dry Plate & Film Co. v. Commissioner, supra,* described the progress payments clause as establishing "a financing arrangement in the nature of a loan," and as not effecting a sale of property.

REASONS FOR GRANTING THE WRIT

1. The decision of the Court of Claims is based upon the legal conclusion that the progress payments made to petitioner under typical Government fixed-price contracts were made in exchange for the sale of work-in-process inventory. This is in direct conflict with the decision of the Seventh Circuit Court of Appeals in *Consolidated-Hammer Dry Plate & Film Co. v. Commissioner,* 317 F.2d 829 (7th Cir. 1963), in which the Seventh Circuit held that under identical contract terms such payments were not paid in exchange for the sale of property, but rather were "attributes of a financing arrangement in the nature of a loan" (317 F.2d 832), precisely as petitioner contends. The Court of Claims dismissed this holding with the statement that "we disagree with its reasoning."

The Court of Claims' decision also conflicts with this Court's *per curiam* affirmance of *American Motors Corp. v. City of Kenosha,* 274 Wis. 315, 80 N.W.2d 363 (1957), aff'd 356 U.S. 21, reh. denied 357 U.S. 912 (1958). The Wisconsin court held that under Government contract provisions essentially identical to those involved here, the

true ownership of the work-in-process inventory remained in the contractor. Thus, no sale was consummated until the delivery and acceptance of the end product and the progress payments were not received in exchange for the sale of property.

These decisions reach conclusions diametrically opposed to the decision of the Court of Claims. These conflicts should be resolved, for, as noted below, they involve recurring issues of great importance.

2. The principal Government contract provision involved in this case is the "title vesting" language of the progress payments clause, set forth at Appendix A, pp. 39-41. The many cases cited by the Court of Claims involving essentially identical language attest to the frequency of important litigation involving its interpretation.

Those cases, like this one, turn on the operative effect of the "title vesting" provision. The importance of uniformity in the interpretation of Government contracts is evident. See *United States v. Blair*, 321 U.S. 730 (1944) (reviewing a decision of the Court of Claims interpreting a Government construction contract); *American Pipe & Steel Corporation v. Firestone Tire & Rubber Co.*, 292 F.2d 640 (9th Cir. 1961). Such questions are ones of Federal law, to be ultimately decided by this Court. *United States v. Allegheny*, 322 U.S. 174 (1944); *American Pipe & Steel Corporation v. Firestone Tire & Rubber Co., supra.*

This Government contract provision, and the decision by the Court of Claims as to its operative effect, directly affects important areas of Federal law other than the statutes involved here. One such area is the state taxation of Government property. The reported cases pertaining to that question are numerous and turn on whether, under the progress payments clause, the ownership of work-in-process inventory and other property is vested in the Government.

See *General Dynamics Corp. v. County of Los Angeles*, 51 Cal.2d 59, 330 P.2d 794 (1958); *City of Detroit v. Murray Corp.*, 234 F.2d 380 (6th Cir. 1956), rev'd 355 U.S. 489, reh. denied 357 U.S. 913 (1958); *Douglas Aircraft Co. v. Byram*, 57 Cal. App.2d 311, 134 P.2d 15 (1943); *State ex rel. Superior Shipbuilding Co. v. Beckley*, 175 Wis. 272, 185 N.W. 199 (1921); *Ford Motor Co. v. Korzen*, 196 N.E.2d 656 (Ill. 1964), cert. denied 13 L.ed. 2d 44 (1964); *American Motors Corp. v. City of Kenosha*, *supra*.

The issues involved in this case also affect questions of Federal income taxation, see *Consolidated-Hammer Dry Plate & Film Co. v. Commissioner*, *supra*, and the immunity of inventory being manufactured under Government contracts from attachment by creditors of the contractor, see *United States v. Ansonia Brass & Copper Co.*, 218 U.S. 452 (1910); *Shepard Engineering Co. v. United States*, 287 F.2d 737, reh. denied 289 F.2d 681 (8th Cir. 1961); *In re Read-York*, 152 F.2d 313 (7th Cir. 1945); *In re American Boiler Works*, 220 F.2d 319 (3rd Cir. 1955).

It is evident that the determination of the operative effect of the title vesting language of the progress payments clause in Government contracts, which is the ultimate issue involved here, affects other cases involving different laws. This case is therefore of substantial importance to other parties and to the development of uniform and predictable rules for the treatment to be accorded property produced and payments made under contracts with the Federal Government.

3. The Court of Claims, in holding that the progress payments were made in exchange for the sale of work-in-process inventory, ignored the obvious intention of the applicable Government contracts. The terms of those contracts, as well as the conduct of the parties, make clear an

intention that the sale take place only when the end product was completed, delivered to, and accepted by the Government. See *Consolidated-Hammer Dry Plate & Film Co. v. Commissioner, supra; American Motors Corp. v. City of Kenosha, supra.*

The provisions of petitioner's contracts with the Government are inconsistent with any other conclusion. The petitioner bears the entire risk of loss prior to delivery. The progress payments bear no relation to the amount of any negotiated contract price, and their payment is in no way contingent upon the inspection or acceptance of any property. The progress payments clause bears a close resemblance to the after-acquired property clause of a conventional mortgage, in that it affects the title not only to property acquired prior to the making of the payment, but to all subsequently acquired property whether or not any further progress payments are made. These facts, as well as others found by the Commissioner and appearing in the Court of Claims' opinion, demonstrate clearly that the progress payments were in fact the equivalent of loans to Government contractors, and not the purchase price for property being sold, and that no sale took place prior to the delivery of the completed product.

Petitioner's assets should reflect the full amount of its investment in the performance of the Government contracts involved, without reduction for partial payments. The Court of Claims erred in holding otherwise, and its decision is of vital importance not only to petitioner, and not only with respect to the Excess Profits Act of 1950, but also to other persons confronted with questions of Federal law which are dependent on the operative effect of the common Government contract clause involved here.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

In the United States Court of Claims

No. 273–59

(Decided November 13, 1964)

THE BOEING COMPANY, A DELAWARE CORPORATION v. THE UNITED STATES

Andrew M. Williams for plaintiff. *James M. Hilton* of counsel.

Theodore D. Peyser, with whom was *Assistant Attorney General Louis F. Oberdorfer*, for defendant. *Edward S. Smith*, *Lyle M. Turner* and *Philip R. Miller* were on the brief.

Before COWEN, *Chief Judge*, LARAMORE, DURFEE, DAVIS and COLLINS, *Judges*.

OPINION

PER CURIAM: This case was referred pursuant to former Rule 45(a) (now Rule 57(a)) to Trial Commissioner Saul Richard Gamer with directions to make findings of fact and recommendations for a conclusion of law. The Commissioner has done so in an opinion and report filed on May 17, 1963. Plaintiff has excepted to the opinion (but not to the findings of fact), the parties have filed briefs, and oral argument has been had. With minor modifications, the court is in agreement with the Commissioner's findings and recommended opinion. Accordingly, the court adopts the findings and opinion, as so modified, as the basis for its

judgment in this case, and concludes that plaintiff is not entitled to recover and that the petition be dismissed.

Commissioner Gamer's opinion, as modified by the court, is as follows:

During the years 1946 through 1949, plaintiff had fixed price Government contracts for the production of aircraft under which it received partial payments during the course of performance. The sole question involved in this case is what effect such payments had on the amount of plaintiff's "assets" for the purpose of computing its excess profits tax liability for the year 1951.

By the Excess Profits Tax Act of 1950 (64 Stat. 1137,[1] as amended by Section 510 of the Revenue Act of 1951, 65 Stat. 452), the Internal Revenue Code of 1939 was amended so as to require the payment by corporations of an excess profits tax. (26 U.S.C. (1952 ed.) §§ 430, *et seq.*) Plaintiff's excess profits tax under this 1950 act was based on its average net income during a pre-1950 base period. By section 446 of the Code, plaintiff, as a member of a "depressed industry subgroup," was permitted to compute such average base period net income by a formula which was based upon the average of the amounts of its "total assets" computed as of certain base period dates. In plaintiff's case, the dates are December 31 for the years 1946–1949, inclusive.

The parties are in dispute as to the effect that the partial payments made by the Government to plaintiff under its aforementioned 1946–49 contracts had on the amount of plaintiff's "total assets" on said four dates. Under the statute, the higher the average base period net income, the lower would be the excess profits tax.

In the performance of the contracts, plaintiff naturally

[1] Enacted January 3, 1951, following the outbreak of the Korean War in June 1950, and therefore sometimes referred to as the Korean War Excess Profits Tax Act.

made expenditures for materials and labor. These expenditures resulted in items of value in the nature of work-in-process inventory. This inventory was justifiably considered as an asset with a value at least equal to the amount of the material and labor expenditures made with respect thereto.

Under the typical contract "Partial Payments" article then in use (set forth in full in finding 4), partial payments were defined as "payments prior to delivery, on work in progress for the Government under this contract." Such payments were permitted to be made "upon property acquired or produced" by the contractor "for the performance of" the contract in an amount which "shall not exceed 90 percent of the cost to the Contractor of the property upon which payment is made." The article then went on to provide that upon the making of any such partial payment "title to all parts, materials, inventories, work in process and non-durable tools theretofore acquired or produced by the Contractor for the performance of this contract, and properly chargeable thereto * * * shall forthwith vest in the Government." It was also provided that, in making final payment for the aircraft, "there shall be deducted from the contract price therefor a proportionate amount of the partial payments theretofore made."

Prior to the enactment of the Excess Profits Tax Act of 1950, plaintiff, in the calculation of its assets on the balance sheets which it submitted with its Federal tax returns and which it published to its stockholders regarded such partial payments as effecting a transaction in the nature of a sale to the Government, accompanied by a passage of title, of an equivalent amount of work-in-process inventory. Thus such inventory asset item was reduced by the amount of the partial payment. In turn, the "cash" asset item was increased by the amount of the payment. In this way, the total amount of plaintiff's assets would not be affected by the payment, there being simply an exchange of cash for work-in-process

inventory. Plaintiff's excess profits tax return for 1951 was filed on this basis, with its total assets as of December 31, 1946–1949, being so computed. However, on the balance sheet submitted with its return for the calendar year 1950, which was the first return submitted after the passage of the Excess Profits Tax Act of 1950, plaintiff for the first time computed its total assets without its work-in-process inventory being reduced by the partial payments, and plaintiff thereafter followed this practice in the balance sheets submitted with all subsequent returns.

In 1955, plaintiff, contending that in its 1951 return it had erred in treating such partial payments as effecting equivalent sales of work-in-process inventory and had thereby erroneously understated its total assets with respect to each of the years 1946 to 1949, filed a claim for refund of excess profits taxes. Instead, plaintiff argued, these "payments" were, regardless of their form, in substance actually nothing more than loans made by the Government to plaintiff to assist it, by replenishing its working capital, in financing its huge aircraft contract operations, and that the payments should therefore be treated as such for the purpose of the tax. Given such treatment as loans, there would be no sale or passage of title and, consequently, no equivalent reduction of the work-in-process asset item by the amount of the partial payment. Plaintiff's cash item would, however, still be increased by the amount of the "loan." Thus, plaintiff's total assets would naturally be much larger. Indeed, with this new method of treating partial payments, plaintiff's assets which, prior to 1950 had been calculated as amounting to approximately $100 million, soared to approximately $150 million, thus raising the base period average and naturally reducing the amount of its subsequent "excess" profits based thereon. Upon the disallowance of its claim, plaintiff filed its petition here to recover

said alleged overpayment of its excess profits tax paid for the year 1951 in the amount of $913,804.64.

In support of its position that the partial payments should be treated as loans and not as payments incident to a sale, plaintiff's principal contention seems to be that the title-passing provision was not intended by the parties to effect such a full transfer of title for actual ownership purposes and that no such ownership transfer was in fact accomplished. Although conceding "that a title of sorts vests in the Government" (Pltf.'s Br., p. 22), and that "in form" the transaction appears as a "payment," plaintiff argues that "in substance" the payments, although not constituting "a conventional loan" (*id.*, pp. 32, 33), amount to nothing more than "cash borrowed from the Government" (*id.*, p. 18) and should, for the purposes of this case, be so regarded. It contends, therefore, that at most the Government receives simply a security title to protect its advances of cash made prior to the final delivery and acceptance of the completed aircraft, only at which time is the "sale" effected. This must, of course, be the heart of plaintiff's contention, for if full title and actual ownership to the work-in-process inventory effectively passes to the Government at the time of the partial payment, then obviously plaintiff would not be justified in considering the Government's property as instead plaintiff's property and including it in a listing of plaintiff's assets.

Further, plaintiff points to various other contract provisions, as well as the practices of the parties thereunder, which it claims are inconsistent with the conclusion that the parties intended that complete ownership, incident to a "sale," of any part of the work-in-process inventory shifts to the Government when the partial payment is made. These provisions and practices include those relating to final inspection, delivery, and payment for completed aircraft, with

plaintiff becoming entitled to "the contract price" only upon final delivery and acceptance of such aircraft; the lack of inspection as a prerequisite to the making of a partial payment; the provision that the contracting officer "may" make partial payments, thus presenting the "hardly likely" situation of leaving the "agreed purchase price to the discretion of the buyer"; the provisions that title to all work-in-process inventory, no matter how large, acquired either prior or subsequent to the first partial payment passes with the making of such payment, no matter how small, thus allegedly making plain that only a type of security title is involved; the lack of relationship between the amount of any partial payment and the contract unit price of aircraft; the nonsegregation of the Government's "property"; the imposition upon plaintiff of the risk of loss of the property, with plaintiff's actually insuring the inventory for its own benefit on the basis of plaintiff's full investment therein, without dimunition on account of partial payments; the disposition rights given to plaintiff during contract performance; and the reversion to plaintiff of title, upon completion of the contract, to all remaining inventory items not incorporated into delivered aircraft, allegedly indicating the real "intention of the parties to buy and sell completed aircraft, and not bits and pieces of inventory." Plaintiff's own intention in this respect is buttressed by its internal books and accounting records—as distinguished from its above-mentioned publicly issued balance sheets—which were kept so as to show the partial payments as a current liability owing to the Government, as would be the case in connection with any loan from a lender, and, similarly, to show, until final delivery of a unit of aircraft was made, its entire investment in the work-in-process inventory, regardless of the source of the funds, as an asset, without reduction to reflect the receipt of partial payments.

Contentions such as these have frequently been advanced

over the years in attempts to escape the effect of the title-passing provision of fixed price Government contract partial payment articles similar to or identical with the one herein involved. They have met with little success. At least to the extent of the partial payments, the courts have, in a variety of situations, almost unanimously sustained the provision as effecting a full and complete passage of title or ownership, and as not creating only a lien or security interest. *United States v. Ansonia Brass & Copper Co.*, 218 U.S. 452 (1910); *Shepard Engineering Co. v. United States*, 287 F. 2d 737 (8th Cir. 1961), *reh. den.* 289 F. 2d 681 (1961); *City of Detroit v. Murray Corp.*, 234 F. 2d 380 (6th Cir. 1956), rev'd on other grounds, 355 U.S. 489 (1958); *General Dynamics Corp. v. County of Los Angeles*, 51 Cal. 2d 59, 330 P. 2d 794 (1958); *Martin Co. v. State Tax Comm'n of Md.*, 225 Md. 404, 171 A. 2d 479 (1961); *In re Read-York, Inc.*, 152 F. 2d 313 (7th Cir. 1945); *Douglas Aircraft Co. v. Byram*, 57 Cal. App. 2d 311, 134 P. 2d 15 (1943); *State ex rel. Superior Shipbuilding Co. v. Beckley*, 175 Wis. 272, 185 N.W. 199 (1921); *Consolidated-Hammer Dry Plate & Film Co. v. Commissioner*, decided April 23, 1962 (C.C.H. Federal Tax Rep. 1962, Vol. 7, Par. 7469(M)) [reversed, 317 F. 2d 829 (C.A. 7, 1963)].

The issue has arisen when the Government contractor has fallen into financial difficulty and, in attempts by its creditors to satisfy their debts out of the contractor's assets, it becomes necessary to ascertain whether certain property in the contractor's possession actually belongs to the contractor or to the Government, Government property, of course, being immune from state materialmen's and mechanics' liens. In the leading *Ansonia Brass & Copper Co.* case, *supra*, creditor-suppliers of a shipbuilding company attempted to enforce liens against a partially built vessel which the company was constructing for the Government under a contract calling for the making of partial payments

during construction. The contract provided that: "The parts paid for under the system of partial payments * * * shall become thereby the sole property of the United States * * *." There too the contention was made that various other provisions of the contract indicated that the parties actually intended that ownership of the vessel remain in the builder until it was completed and turned over to the Government. However, the Court, after holding that "if the contract is such as to clearly express the intention of the parties that the builder shall sell and the purchaser shall buy the ship before its completion, and at the different stages of its progress, and this purpose is expressed in the words of the contract, it is binding and effectual in law to pass the title" (p. 467), rejected the contention that any other provisions of the contract, when "read in the light of the purposes of the contracting parties as gathered from the entire contract," negatived the plain wording of the ownership provision. The contract provisions as to the Government's rights of inspection and rejection upon completion of the vessel, the builder's duty to keep the property insured, and other duties imposed upon it with respect to the property, were not, the Court held, inconsistent with the provision "passing * * * the title in parts as paid for" and did not serve to "cut down or lessen the binding force of the clear and distinct provisions * * * as to ownership."

> The parties therein dealt with a specific part of the contract, they expressed themselves clearly upon the subject, and it is not to be presumed, in the absence of clear expression or necessary implication, that they intended to supersede this provision in dealing with other specific or general parts of the agreement. (p. 469)

Since full title to the uncompleted vessel thus effectively passed to the Government under the partial payment provision, the Court held that the creditors were powerless to

levy on the Government's property. However, as to two other vessels being constructed under contracts which did not contain a "stipulation as to passing of the title on partial payments in the progress of the work" (p. 472), the Court did sustain the suppliers' liens.

Plaintiff's attempt to distinguish the *Ansonia* case on the grounds that there the parties clearly contracted "that services or products shall be sold and paid for as the work progresses, and at various stages of performance" (Pltf.'s Br., p. 19) is unconvincing, for the provisions for title passing as an incident to the system of partial payments are substantially similar to those herein involved.

In *Shepard Engineering Co. v. United States, supra,* a bankrupt prime contractor's work-in-process inventory was covered by a Government contract partial payment title-passing provision which was identical with the provision in the instant case. Its attempted sale of a part of the inventory to a third party was held to be void since the title to the property had, under the provision, vested in the Government prior to the sale "to the innocent purchaser for value without notice." The court stated: "There is no ambiguity in the words of the contract that the material 'shall forthwith vest in the Government' and there is no reason why the contract should not be enforced by the courts" (287 F. 2d, at 741.) And further, "that at the time of this purported purchase" the prime contractor "had no title to transfer—under the clear and unambiguous terms of the partial payments clause, title had vested in the United States." (289 F. 2d, at 682.)

The *Read-York, Inc.* case, *supra,* similarly presented the situation of creditors attempting to reach incomplete gliders being constructed by a bankrupt Government contractor under an Army Air Force contract containing a partial payment title-passing provision. Again the court, after con-

sidering the partial payment article and various other contract provisions alleged to be inconsistent with the title-passing provision, held, principally on the authority of *Ansonia Brass*, that, as to the partial payment article, "it would be difficult to state in more precise terms the conditions upon which title to the property vests in the Government," and, as to the other contract provisions "we find nothing in any other section of the contract inconsistent with" such article. (152 F. 2d, at 316.)

Indeed, a title-passing provision standing alone and without being incident to a partial payment provision has been held to be effective as against the creditors of a bankrupt Government contractor. See *In re American Boiler Works*, 220 F. 2d 319 (3d Cir. 1955), where the court held that, with respect to a bankrupt builder of vessels for the Navy, a provision in the contract to the effect that "title to all materials and equipment acquired for each vessel shall vest in the Government upon delivery thereof to the plant of the Contractor or other place of storage selected by the Contractor" was effective "without any mention of payment as a prerequisite thereto." (p. 321.)

Cases involving various types of taxes have arrived at the same result. Most of these are personal property tax cases in which the validity of the assessment was dependent upon ownership of the property since Federal Government property is, of course, immune from direct state or local taxation. *United States v. Allegheny County*, 322 U.S. 174 (1944). In the *General Dynamics* case, *supra*, county and city ad valorem personal property taxes were assessed against a Government contractor operating under fixed price contracts containing what was therein described as a progress payment clause[2] with a title-passing provision. Al-

[2] The parties here have used the terms "progress payment" and "partial payment" synonymously and interchangeably.

though conceding that "a title clause standing alone is not conclusive of ownership for tax purposes when it appears that the taxpayer retains the essential indicia of ownership * * * or that the government title is for security only" (330 P. 2d, at 798), the court, after reviewing the other allegedly inconsistent contract provisions, including those giving the contractor certain rights to dispose of the inventory, as well as those placing the risk of loss on the contractor, concluded they were "not inconsistent with the government's ownership of the property for tax purposes during the crucial period when title was vested in it." (p. 800.) It pointed out that the contractor's right to dispose of the property was a limited one. This is also true in the instant case, as article 46(d) (finding 4(c)) makes plain. And it further held, relying on the *Ansonia Brass* case, that "the mere fact that the risk of loss was borne by the contractor is not inconsistent with government ownership." (p. 801.) See, also, *Martin Co. v. State Tax Comm'n of Md., supra.*

Again in *City of Detroit v. Murray Corporation, supra*, city and county personal property taxes were held to have been illegally assessed upon property in the possession of an Air Force subcontractor pursuant to a subcontract similarly containing a partial payment title-passing provision which appears to have been identical with the article herein involved, providing, as does the instant article, that upon the making of any partial payment title to the specified inventory and work in process should "forthwith vest in the Government." The court not only rejected the contention that the partial payment and transfer of title clause was invalid, but sustained the holding of the District Court "that under the partial payment clauses title to the property in question was vested in the United States * * * and that this is an *absolute* and not a bare lien or security title * * *."

(234 F. 2d, at 381)[3]. To the same effect is *Douglas Aircraft Co. v. Byram, supra,* where the court similarly held invalid county and city property taxes levied against partially constructed airplanes and certain materials covered by a Government contract containing a partial payment title-passing provision. Rejecting the contention that "if title did pass to the federal government, it was at most a bare, legal title, for security only, the beneficial title remaining in the" contractor, the court concluded that "the terms of the contract providing that title passes contain no suggestion that it is taken for security only." (134 P. 2d, at 17.)[4]

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[3] For the thesis that partial payment articles are illegal as violative of Revised Statutes, § 3648 (31 U.S.C. § 529), providing that "no advance of public money shall be made in any case * * *," see McClelland, *The Illegality of Progress Payments as a Means of Financing Government Contractors*, 33 Notre Dame Law. 380 (1958). The history of the series of holdings by the Attorney General and the Comptroller General establishing "that payments under contracts may be made where the United States receives an equivalent benefit therefor in the form of transfer of title to contract materials or work in progress" is set forth in Whelan, *Government Supply Contracts: Progress Payments Based on Costs; The New Defense Regulations*, 26 Fordham L. Rev. 224 (1957) at 231, *et seq.* Plaintiff in the instant case does not question the legality of the partial payment article.

[4] The court relied heavily on the holding in the similar case of *Craig v. Ingalls Shipbuilding Corp.*, 192 Miss. 254, 5 So. 2d 676 (1942). Instead of a fixed price contract with a partial payment clause, the contractor in *Craig* held a cost-plus contract which did, however, contain a similar provision for passage of title to property "on account of which payments are made." The court there concluded that state, county, and municipal ad valorem tax assessments on such property were invalid.

However where, in the personal property tax cases, it is, in other types of situations, plain that the Government's title is only for security purposes, the property is held to be subject to local taxation. For instance, where the Government as title holder is in the position of a seller (instead of a buyer, as in the instant case), with a balance due on account of the purchase price, it will be recognized that it "retains only a legal title as security" since in such a case it is in substance simply in the position of a mortgagee. *S.R.A., Inc. v. Minnesota*, 327 U.S. 558, 565 (1946). To the same effect is *Offutt Housing Co. v. Sarpy County*, 351 U.S. 253, 261 (1956), where the Government's title was held to be only a "paper title" to secure it for moneys owed on a Wherry Military Housing Act project.

American Motors Corp. v. City of Kenosha, 274 Wis. 315, 80 N.W. 2d 363 (1957),[5] is the one case which supports plaintiff's contentions. Holding that "the question of ownership for tax purposes is one of local law," the court concluded that a city personal property tax on property ("aircraft engine inventory," consisting of raw materials, supplies, work in process and completed parts) located at the plant of a Government contractor building aircraft engines for the Air Force under a contract containing a partial payment title-passing clause was valid as constituting a tax on the contractor's, and not the Government's, property. After examining the terms of the contract other than the title-passing provision, the court held that although "title" passed to the Government, the contractor was nevertheless "the true owner" of the property.[6] The court held: "In our opinion, the unrestricted right of the Company under the contract to acquire and dispose of the property and the risk of loss are elements of ownership inconsistent with the vesting of such title in the Government as would render the property immune from taxation." (80 N.W. 2d, at 367.)

However, as the Court in the *General Dynamics Corp.* case pointed out, the authority of *American Motors Corp.* is

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[5] Motion to affirm granted *per curiam*, 356 U.S. 21 (1958), evidently on the same basis as the Supreme Court's holding in *City of Detroit v. Murray Corp.*, 355 U.S. 489 (1958), i.e., that although the state tax was styled a "personal property tax," it was, as actually applied, a tax on the possession and use of property, regardless of ownership. The Court specifically stated (at 492, fn. 2) that: "For purposes of this case we assume that the United States had full title to the property not just a bare security interest."

[6] The court felt constrained to make this distinction between "title" and "ownership" in view of the Supreme Court's holding in *United States v. Allegheny County*, *supra*, that: "The validity and construction of contracts through which the United States is exercising its constitutional functions, their consequences on the rights and obligations of the parties, the titles or liens which they create or permit, all present questions of federal law not controlled by the law of any State" and its conclusion in that case "that title to the property in question is in the United States and is effective for tax purposes." (at 183.)

weakened because of the court's seeming misconstruction of the provisions of the contract concerning the contractor's "unrestricted" right during contract performance to dispose of the inventory. The court in *General Dynamics* stated: "The decision in the American Motors case, however, appears to have overlooked the fact that the contractor's right to acquire or dispose of the property other than scrap could only be exercised at the option of the government. Until such option was exercised in favor of the contractor, it * * * had no right to acquire or dispose of government property." (330 P. 2d 801.) The identical option language is contained in the article herein involved. And the court went on to criticize the *American Motors* holding by reiterating "that the mere fact that the risk of loss was borne by the contractor is not inconsistent with government ownership," as was made plain by the Supreme Court's *Ansonia Brass* holding, which apparently had not been called to the court's attention in the *American Motors* case, for it fails to even mention it, as it similarly fails to mention its own earlier decision to the contrary in *State ex rel. Superior Shipbuilding Co. v. Beckley, supra.*[7] In the latter case, the court, relying principally on *Ansonia Brass*, held invalid state personal property tax assessments against a Government contractor building vessels covered by a partial payment title-passing clause. It stated: "If it is possible to use language which is plain and definite passing the title to partially constructed vessels and the materials on the premises designed therefor, it must be conceded that the language of the contract in this case does it" and that "the fact that the contract contained other clauses relating to insurance, * * * does not operate to modify the clear intent of the parties as expressed

[7] As was noted by Justice Whittaker in his dissenting opinion in *City of Detroit v. Murray Corp., supra,* at 524, fn.9. The dissent was to the Court's construction of the tax as being one on the possession and use of property rather than an ad valorem personal property tax.

in the language of the contract relating to the time when the title shall pass." (185 N.W., at 201.)

And as to income taxes, the Tax Court arrived at the same result in the *Consolidated-Hammer Dry Plate & Film Co.* case, *supra*. Since it held that partial payments made pursuant to Air Force contracts upon submission of invoices certifying costs incurred (as in the instant case) were payments received without restriction and resulted in title to the property vesting in the Government on the date of payment, it concluded that such payments were includible in the contractor's income in the year of receipt and not upon the later delivery of the final product. Plaintiff seeks to distinguish this case on the grounds that it is one involving income taxes and the time when taxable income was received, and that it therefore does not involve or require a determination of plaintiff's assets, as does the instant excess profits tax. But the essence of plaintiff's contention in the determination of its assets is "that the partial payments involved in this case are not payments of the contract price for work previously done." (Pltf.'s Br. [to the Commissioner], p. 27.) And this is exactly what the Tax Court held they were, with a resultant passage of title to the Government. Were the partial payments in effect nothing more than loans, as both the taxpayers there and here contend, there would have been no passage of title, the property would therefore have remained in plaintiff's inventory as its assets, and the payments could not have been regarded as income when received.*

* Since the Commissioner's opinion was filed, the Seventh Circuit has reversed the Tax Court in the *Consolidated-Hammer* case. 317 F. 2d 829, decided May 21, 1963. Insofar as the Court of Appeals viewed the partial payments clause as establishing "a financing arrangement in the nature of a loan," we disagree with its reasoning. However, that case involved the income tax, not the special provisions of the excess profits tax here in issue, and the Seventh Circuit's ultimate conclusion may conceivably be sustainable on the income tax facts it thought it had before it, or on other grounds irrelevant to the present case.

On the other hand, where moneys paid under a contract are, as a result of "a careful study of the contract * * * and of the actions of the parties under" the contract, determined to be "advances * * * in the nature of loans," the advances have been held not to constitute income at the time they were made. *Summit Coal Co. v. Commissioner*, 18 B.T.A. 983, 988 (1930). In the *Summit Coal* case, the advances were made prior to contract performance and notes were given to evidence the indebtedness. To the same effect is *Veenstra & DeHaan Coal Co.*, 11 T.C. 964 (1948), where advance deposits by customers to be applied to later deliveries of coal at then prevailing prices were held not to constitute taxable income in the year when the deposits were received.

With the exception of *American Motors*, all of the above discussed cases in which Government contract partial payment articles with title-passing provisions were involved, as in the instant case, reject practically every contention plaintiff here makes concerning whether a sale occurs and title passes. However, the case of *Anderson Brothers Corporation v. Commissioner*, 296 F. 2d 627 (5th Cir. 1961), is an even stronger holding against plaintiff because it involves the precise assets determination issue under the same 1950 Excess Profits Tax Act as is herein involved in a situation where a partial payment clause contained in a private contract does not appear to have been accompanied by any title-passing provision. Yet the court there too held, in affirming the Tax Court (34 T.C. 199), that the taxpayer, a pipeline contractor receiving such partial payments from its customers on the basis of a percentage of the work done during a preceding period (as is true in the instant case) could not include in its assets both its "Work in Progress" investment and the partial payments received with respect thereto. The taxpayer's "Work in Progress" asset item was, the court held, to be reduced to the extent of the payments.

This is, of course, simply another way of saying that the partial payment constituted a true "payment" for the appropriate percentage of inventory work-in-process accomplished theretofore, and to that extent a sale had resulted with a concurrent passage of title to the property from the contractor to its customers who had paid therefor.

Plaintiff argues that this case too is to be distinguished in that the partial payments were, by the very nature of the subject matter of the contract, in fact true current *pro tanto* payments for completed work, i.e., pipeline laid in place "with no work in process thereafter held by the taxpayer." (Pltf.'s Br. [to the Commissioner], p. 28.) But there is nothing in the opinions of either the Tax Court or the Fifth Circuit to so indicate. The alleged lack of any such work-in-process would be wholly inconsistent with the primary concern of the litigation, i.e., how the partial payments affected the "Work in Progress" asset item. And on this issue, and in clear rejection of plaintiff's contentions here, the Tax Court flatly held that " 'payment' has a specified and clear meaning which is that a claim has been paid. 'Payment' is clearly distinguishable from loans and advances." And the Court of Appeals, in affirming, similarly held that "no amount of theory can overcome the fact, which is that a creditor seeking to seize the property of such a contractor would not be able to reach both the item representing expenditures on uncompleted contracts and the cash sums actually paid by the owner and received of the contractor in repayment of these expenditures." (296 F. 2d, at 630.)

Thus, as noted above, a title-passing clause without any accompanying partial payment provision *(In Re American Boiler Works, supra)*, as well as a partial payment clause without any accompanying title-passing provision, as in the *Anderson Brothers Corporation* case, each standing alone, have been held to have effectively transferred ownership in inventory or work-in-process. Certainly, in the instant sit-

uation, as shown by the cases hereinabove set forth, where the contract contains both provisions, the ownership transfer is all the more soundly based.[8]

The contention that, because discretion is vested in the contracting officer in that he "may" make the partial payments, the status of such payments as true sale payments is weakened while their status as loans is enhanced, is not persuasive. It could be equally argued that it would be hardly likely that there would be vested in the contracting officer the unlimited discretion as to whether or not "loans" to the extent of millions of dollars should be made to the contractor. *United States v. Lennox Metal Mfg. Co.*, 225 F. 2d 302 (2d Cir. 1955).

And as to the further contention relating to the passage of title to greater amounts of property than the actual amounts of the partial payments, any such problem would here appear to be academic since defendant is simply con-

[8] This is not to say that every construction type contract calling for installment payments as the work progresses will automatically be held to effect equivalent concurrent title transfers. The basic problem in each case is to ascertain "the presumed intention of the parties." *Clarkson v. Stevens*, 106 U.S. 505, 515 (1882). In that case the Court held that despite such payments made under a Navy contract for the construction of a ship, and despite a contract provision that the construction materials should be marked with the letters "U.S." and should become the Government's property, it was not the actual intention of the parties, as shown by other circumstances, that any title should pass to the Government until the ship was completed and delivered. "The courts of this country have not adopted any arbitrary rule of construction as controlling such agreements, but consider the question of intent, open in every case, to be determined upon the terms of the contract, and the circumstances attending the transaction" (p. 515). And in *Armstrong v. United States*, 364 U.S. 40 (1960), where a shipbuilding contract provided for the making of progress payments based on a percentage of the work completed, but without any provision "that ownership of the portion of the work paid for should vest in the United States" (p. 43), the Court held that materialmen's liens on the partially constructed vessels could not be extinguished by a later transfer of title to the Government of the uncompleted vessels. The *Ansonia* case, with its title-passing provision as a part of the partial payment clause was distinguished.

tending that the work-in-process asset item be, for the purpose in question, reduced only to the extent of the partial payments.

The conclusion that the partial payments are here to be considered as true contract sale payments and not loans is not to deny, as plaintiff points out, that in a broad financial or economic sense, partial payments are concededly one way of financing Government contractors and in that respect perform quite the same general function as loans. The Defense Department Regulations specifically so recognize. See *Armed Services Procurement Regulations*, 32 C.F.R., Part 163, App. E.; Whelan, *Government Supply Contracts: Progress Payments Based on Costs; The New Defense Regulations*, 26 Fordham L. Rev. 224 (1957). "Progress payments are the largest single segment of contract financing in the Department of Defense." Bachman, *Defense Department Contract Financing*, 25 Geo. Wash. L. Rev. 228, 229 (1956). The other two principal contract financing methods in which the Government participates (as distinguished from purely private financing) are Government guaranteed loans made by private lenders ("V-loans") and advance payments, which precede contract performance. See Bachman, *supra*. Progress payments are "singularly advantageous" however, because, unlike the other two methods, they do not bear interest nor are they secured. Whelan, *supra*, at 229. Advance payments are, as plaintiff concedes, true loans. See *United States v. Butterworth-Judson Corp.*, 267 U.S. 387 (1925).

And, indeed, for certain purposes, where consideration must be given to how much Government aid a contractor has received as distinguished from private financing, progress payments may be put in the same general category as Government loans. For instance, in determining the reasonableness or excessiveness of profits under the Renegotiation Act, and in applying the guides provided by the act and the

regulations for such determination, including such factors as the financial risks undertaken in performing the contract and the amount of Government aid it received, the Tax Court in *Boeing Airplane Co. v. Renegotiation Board*, 37 T.C. 613 (1962), considered the fact that the contractor "was an inadequately financed and equipped airframe manufacturer" (p. 648), that its "operations were largely financed by the United States through early reimbursement of costs and payments of profit through progress payments and the furnishing of Government-owned manufacturing facilities" (p. 647), and that "we view these payments regardless of their labels as in the nature of loans." (p. 648.) But the fact that for certain general policy purposes partial payments may be considered as a form of contract financing and in the category of loans does not, as the many cases hereinabove analyzed make clear, put them in that category when it is necessary to ascertain the legal relationships they create, including the passage of title, in accordance with specific contract provisions, and the effect such passage has on the amount of a company's assets.

As Justice Whittaker stated in *City of Detroit v. Murray Corp.*, 355 U.S. 489, (p. 517, fn. 4, dissenting opinion, the majority opinion being based on grounds other than those herein involved) in considering the difference between "advance payments" and "partial payments":

> * * * At the time the Act [Armed Services Procurement Act of 1947, c. 65, 62 Stat. 21] was passed the terms "advance payments" and "partial payments" had long since become terms of art in government procurement laws and regulations. * * * The two terms are not synonymous. It has long been recognized and understood that an "advance payment" is a loan by the Government and can be made "only upon adequate security" as provided in § 5 of the Armed Services Procurement Act, but "partial payments" are payments made by the Government in purchase of mater-

ials and are authorized when ownership thereto vests in the Government. Army Procurement Regulations (November 18, 1947), §§ 804.400-7, 805.405, 805.407-2 (a)(b), 12 Fed. Reg. 7692-7693, 7700, 7704-7705. The distinction is made clear in Armed Services Procurement Regulations of November 23, 1950 (32 CFR (1949 ed.) § 402.501), saying:

> "Advance payments shall be deemed to be payments made by the Government to a contractor in the form of loans or advances prior to and in anticipation of complete performance under a contract. *Advance payments are to be distinguished from 'partial payments' and 'progress payments' and other payments made because of performance or part performance of a contract.*" [Emphasis supplied by Justice Whittaker.]

Plaintiff makes no convincing showing either by legislative history or otherwise that Congress intended that, in the determination of a corporation's assets for the purpose of the Excess Profits Tax Act herein involved, such contract partial payments should not be given the treatment the parties clearly intended by the contract terms and as long interpreted by the courts, and that there was instead some other purpose to be served based upon the broad economic and financial effects of such payments. The contention that the work-in-process inventory was an asset created by plaintiff "regardless of the source of the money expended," and that "plaintiff's assets should be reflected in the full amount of the investment in the performance of the contract * * * until such time as sold" (Pltf.'s Br. [to the Commissioner], pp. 18-19), assumes the very point in question, i.e., the time when the assets were "sold." For certainly, plaintiff's "investment" in the creation of the asset was reduced when it became reimbursed therefor to the extent of the partial payment.

In the *Anderson Brothers Corporation* case, *supra*, the Tax Court, in addressing itself to the congressional intent in

enacting the Excess Profits Tax Act herein involved, could find no purpose as would call for disregarding the effect of partial payment clauses. On the other hand, the court held that it would be "inequitable" and violative of the congressional purpose "to permit the computation of excess profits credits on duplicating assets" (34 T.C., at 204), and that "the legislative purpose seems to us to preclude the recognition as an asset of items which tend to be merely duplication of other assets." (34 T.C., at 205.)

Plaintiff contends that Congress, in enacting this act, could not have intended to discriminate between contractors obtaining financing through advance payments, guaranteed loans, or private loans, on the one hand, and partial payments on the other hand, in that the former unquestionably would have their assets increased by the amount of the loan. However, this overlooks the basic fact that, in the formula for the computation of the "average base period net income" under section 446(b) (4) and (5) of the 1939 Code, there must be deducted the interest paid or incurred by the taxpayer during the base period (average base period assets × the industry rate of return—the interest paid during the base period). Thus, those who operate under loans would not necessarily be favored at all, for loans are, of course, ordinarily interest bearing. Indeed, should partial payments be considered as loans for the instant purpose, the favoritism might well be in plaintiff's favor, because this would be a peculiar type of non-interest bearing "loan" and the application of the formula would call for a large increase in the assets part of the formula without any interest reduction whatsoever, whereas other contractors financing their operations through true or conventional loans would be subject to the interest deduction. The Tax Court in the *Anderson Brothers Corporation* case noted that the adoption of the taxpayer's contention "means, of course, the

elimination of the offset to excess profits credit * * * consisting of interest, which is presumably intended to measure the effect of borrowed capital on petitioner's income." 34 T.C., at 203.[9]

The parties here, as did the parties in the *Anderson Brothers Corporation*, case, *supra*, presented evidence of accounting practice. However, as the Tax Court stated in *Anderson Brothers*, the problem is not "primarily one of accounting practice" (34 T.C., at 203). And the Fifth Circuit, in affirming, similarly stated that "giving every proper deference to the theoretical accounting arguments * * * it would seem that even to pose the proposition that the expenditure item continues to be property even after cash has been received in full payment of the amount of the expendi-

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[9] Of course, if, as plaintiff points out, plaintiff's industry engages primarily in Government business and finances such business substanially through partial payments, there would be little, if any, discrimination in plaintiff's favor as against other members of the industry group.

Similarly, it may well be that the industry has in a sense been otherwise prejudiced under the act by the nonpayment of interest on partial payments so that the benefit resulting from the lack of an interest deduction in computing the average base period net income would only be in essence somewhat of a compensating factor. Such prejudice would come about as a result of the statutory formula for calculating the industry rate of return. Under section 446(d)(1)(2) such rate of return is determined by adding the interest paid by the corporations in the industry during the prescribed base period to their net income for such period, and then dividing such total by their aggregate assets. Thus, the lower the interest payments by the industry, the lower the industry's rate of return. And correspondingly, the lower the rate of return, the lower would be plaintiff's average base period net income.

However, in their application to the situation of any individual industry member, these considerations would appear to border too much on speculation. In any event they would be more appropriately addressed to the Congress which could, of course, specifically legislate on the mattter, as it did, for instance, when it included, in section 439(g)(1), indebtedness evidenced by conditional sales contracts within the definition of "borrowed capital."

tures is to answer it." (296 F. 2d, at 630.)[10] As shown, what is determinative is the proper interpretation of the contract as to the effect and the legal consequences of partial payments. True, insofar as such interpretation is dependent upon the intent of the parties, and insofar as the accounting practices that were contemporaneously adopted may throw light upon such intent, such practices may well be relevant. Plaintiff now concedes that this is the only pertinency the accounting aspects have in this case. And in this connection, plaintiff places special emphasis on the accounting procedure relating to the submission of bills following delivery of completed aircraft. Upon such delivery, the practice was for plaintiff to submit a bill to the contracting officer for the full unit contract price. Such officer then forwarded the bill (together with the supporting documents) to the Air Force Finance Officer, who then applied against the bill the amount of the partial payments previously made. Plaintiff concludes that this practice of billing for the full unit price of the aircraft at the time of the delivery of the completed aircraft evidences the fact that the parties intended that no sale was made until such delivery was effected.

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[10] Where a contractor's books are kept on the completed contract basis of accounting, the contractor is permitted to wait until the contract is fully completed before income is reported. Accordingly, as appeared in the *Anderson Brothers Corporation* case, it would be proper for such a contractor for such purpose, "to accumulate its expenditures under an asset item for bookkeeping purposes and then to accumulate actual payments which are thereafter received as partial payments under the contract in some sort of a reserve account which does not offset the asset item on the books until the contract is finally completed and it has been determined that there has been a profit or loss on the transaction." (296 F. 2d, at 630). The court went on to hold, however, that such accounting practice for that particular purpose would not be determinative of the question of "what cash or property a taxpayer actually had on" a certain date and that to apply it for such purpose would be "completely fallacious." (*id.*)

Plaintiff infers too much from this billing procedure. As a matter of mechanics, it seems plain that there would be little difference between giving credit for the prior partial payments as part of the bill, and merely billing for the balance due, or, as was the adopted procedure, preparing the bill in the full amount of the unit price and then applying the partial payments against the billing. Either procedure would appear to be consistent with the partial payments being considered as either true contract payments or as loans.

Equally unconvincing is plaintiff's further contention that because the partial payments were measured by and restricted to a percentage of plaintiff's expenditures, without any allowance for profit, they therefore cannot be considered as true sale payments since it would mean that plaintiff would be indulging in the hardly likely operation of making current sales at a loss. Since the payments are, by their very nature and designation, only "partial" payments, the formula applied to determine their amounts would hardly be of substantial significance on the question of their true nature. If the practices and mechanics adopted in connection with the making of the partial payments is of significance, it could equally be pointed out that the partial payments were made pursuant to "bills" or "invoices" prepared and submitted by plaintiff—terminology customarily applied in the business world to "sales."

On this question of intent and how plaintiff regarded the partial payments, of far greater significance is the fact that plaintiff, prior to the 1950 act in question, on its public balance sheets as well as those submitted with its tax returns, did regard partial payments as effecting equivalent sales of work-in-process inventory, reducing such asset item by the amounts of the payments. As was true in the *Anderson* case,

it seems quite clear that plaintiff changed its "long-continued method of accounting" only when "it became advantageous to do so for tax purposes." (34 T.C., at 205.)[11]

[11] However, on the intent issue, it is true, as hereinabove noted, that, as distinguished from its balance sheets, plaintiff has consistently treated partial payments in its internal accounts as advances of working capital and classified them as current liabilities. The testimony of its expert accounting witness was to the effect that this was a permissible method. However, his testimony was that treating the partial payments as offsets to the work-in-process inventory asset item would also be proper.

The conclusion that accounting practices are not determinative of the particular problem here in issue does not result from any lack of accounting authority to support the legal conclusion hereinabove arrived at. Plaintiff's former method of preparing its balance sheets were certified by independent accountants as being "in accordance with accepted principles of accounting" (finding 16(a)). Practically all the other aircraft companies, both before and after the passage of the act, prepare their balance sheets on that basis. Also, the American Institute of Accountants, "long a source of thoughtful guidance to the accounting profession and of increasing importance to lawyers" (Herwitz, *Accounting for Long-Term Construction Contracts: A Lawyer's Approach*, 70 Harv. L. Rev. 449, 450 (1957)), in its Accounting Research Bulletin No. 45, pertaining to "Long-term Construction-type Contracts," provides, with respect to the two accounting methods commonly followed by contractors, the "percentage of completion method" and the "completed contract method," that, as to the former, "current assets may include costs * * * not yet billed" (par. 5) and as to the latter, only "an excess of accumulated costs over related billings should be shown in the balance sheet as a current asset" (par. 12). As to terminology, it suggests "that the asset item be described as 'costs of uncompleted contracts in excess of related billings' rather than as 'inventory' or 'work in process' * * *" (par. 12).

Herwitz's rather strong criticism of this bulletin does not relate to the problem involved in the instant case.

Plaintiff's contention that this bulletin is inapplicable in that it refers only to construction contracts rather than the type of contract herein involved seems unwarranted. The bulletin refers to "Construction-type Contracts," and a long-term contract for the building of airplanes would seem to fall in this category. The bulletin specifically provides that it "would also be applicable in appropriate cases to the manufacturing or building of special items on a contract basis in a contractor's own plant" (par. 1).

FINDINGS OF FACT

The court, having considered the evidence, the report of Trial Commissioner Saul Richard Gamer, and the briefs and argument of counsel, makes findings of fact as follows:

1. At all times hereinafter mentioned, plaintiff has been and is now a corporation organized and existing under the laws of the State of Delaware and having its principal place of business at Seattle, Washington. Plaintiff commenced business on or about August 31, 1934.

2. On or about September 15, 1952, plaintiff filed with the Collector of Internal Revenue at Tacoma, Washington, its U.S. Corporation Income Tax Return for the calendar year 1951, which return reported a total Federal income tax for that year in the amount of $9,160,011.93 and a total Federal excess profits tax for that year in the amount of $2,294,280.88, together totaling $11,454,292.81. Plaintiff made the following payments to the Collector or District Director of Internal Revenue, on or about the dates indicated, with respect to its 1951 Federal income and excess profits tax:

	Total payment	*Excess profits tax included*
March 15, 1952	$4,445,000.00	
June 15, 1952	4,445,000.00	
September 15, 1952	846,148.89	
December 15, 1952	1,718,143.92	
Total tax per return	11,454,292.81	$2,294,280.88
July 8, 1957—Deficiency per revenue agent's report	184,405.11	178,783.47
Total payments	11,638,697.92	2,473,064.35

On June 2, 1959, the District Director refunded to plaintiff $4,158.63 in principal amount of tax.

3. Plaintiff's principal business activity has been and is now the manufacture of military and commercial aircraft. During the years 1946 to 1949, inclusive, plaintiff's princi-

pal military production programs, carried on under Government contract, were the C–97 military cargo transport and the B–50 bomber. Contract W33 (038) ac–19823 was a contract under which B–50 bombers were procured, and this contract, exclusive of the precise work to be performed and the stated prices, was typical of the fixed price contracts involved in the 1946–49 period.

4. (a) Contract 19823, entitled a "contract for supplies," called for 132 B–50D airplanes, spare parts and data. By article 15(a), item 1, plaintiff agreed to furnish and deliver such aircraft to the Government at a unit price of $699,671.82 and total price of $92,356,680. The aircraft were to be manufactured and supplied in strict accordance with a stated model specification. Deliveries of completed aircraft were to be made in accordance with a delivery schedule specified in the contract. The contractor was to be paid "upon the submission of properly certified invoices or vouchers, the prices stipulated herein for articles delivered and accepted or services rendered, less deductions, if any, as herein provided."

(b) Prior to delivery of the aircraft, the contractor was responsible for all the articles and materials covered by the contract. The contract provided for periodic inspection of work in process, prior to delivery, but such inspection and approval did not relieve the contractor from responsibility for defects in materials and workmanship subsequently discovered prior to final acceptance. However, the contract provided for final inspection and acceptance of completed aircraft after delivery, and provided that such acceptance would be conclusive except as regards latent defect, fraud, or such gross mistakes as amount to fraud.

(c) Article 46 of the contract authorized the Air Force contracting officer to make partial payments to the contractor. Said article provided as follows:

ARTICLE 46—*Partial Payments*—Partial payments, which are hereby defined as payments prior to delivery, on work in progress for the Government under this contract, may be made upon the following terms and conditions:

(a) The Contracting Officer may, from time to time, authorize partial payments to the Contractor upon property acquired or produced by it for the performance of this contract; Provided, that such partial payments shall not exceed 90 per cent of the cost to the Contractor of the property upon which payment is made, which cost shall be determined from evidence submitted by the Contractor and which must be such as is satisfactory to the Contracting Officer; Provided, further, that in no event shall the total of unliquidated partial payments (see (c) below) and of unliquidated advance payments, if any, made under this contract, exceed 90 percent of the total contract price of supplies still to be delivered.

(b) Upon the making of any partial payment under this contract, title to all parts, materials, inventories, work in process and non-durable tools theretofore acquired or produced by the Contractor for the performance of this contract, and properly chargeable thereto under sound accounting practice, shall forthwith vest in the Government; and title to all like property thereafter acquired or produced by the Contractor for the performance of this contract and properly chargeable thereto as aforesaid shall vest in the Government forthwith upon said acquisition or production; Provided, that nothing herein shall deprive the Contractor of any further partial or final payments due or to become due hereunder; or relieve the Contractor or the Government of any of their respective rights or obligations under this contract.

(c) In making payment for the supplies furnished hereunder, there shall be deducted from the contract price therefor a proportionate amount of the partial payments theretofore made to the Contractor, under the authority herein contained.

(d) It is recognized that property (including, without limitation, completed supplies, spare parts, drawings, information, partially completed supplies, work in process, materials, fabricated parts and other things called for herein) title to which is or may hereafter become vested in the Government pursuant to this Article will from time to time be used by or be put in the care, custody or possession of the Contractor in connection with the performance of this contract. The Contractor, either before or after receipt of notice of termination at the option of the Government, may acquire or dispose of property to which title is vested in the Government under this Article, except that if any major assembly is acquired or disposed of, the Contractor shall obtain approval of the Contracting Officer prior to the transfer or other disposition of such assembly, provided, that, after receipt of notice of termination, any such property that is a part of termination inventory may be acquired or disposed of only in accordance with the provisions of the termination article of this contract and applicable laws and regulations. On or before the 10th of each month the Contractor shall make a written report to the Contracting Officer listing the property sold or disposed of pursuant to the foregoing sentence during the preceding month. If, in the opinion of the Contracting Officer, 90% of the cost of the property referred to in paragraph (a) hereof, and not disposed of at the date of such report is less than the unliquidated partial payments under this Article, he may notify the Contractor in writing of the amount by which in his opinion, the unliquidated partial payments exceed 90% of the costs of the property referred to in paragraph (a) which has not been disposed of, and the Contractor shall thereupon pay or credit the amount of such excess to the Government, as the Contracting Officer shall direct. Upon liquidation of all partial payments hereunder or upon completion of deliveries called for by this contract, title to all property (or the proceeds thereof) which has not been delivered to and accepted by the Government under this contract or which has not been

incorporated in supplies delivered to and accepted by the Government under this contract and to which title has vested in the Government under this Article shall vest in the Contractor.

(e) The article of this contract captioned "Liability for Government Property" shall be inapplicable to property to which the Government shall have acquired title solely by virtue of the provisions of this Article. The provisions of this Article shall not relieve the Contractor from risk of loss or destruction of or damage to property to which title vests in the Government under the provisions hereof.

(f) If this contract (as heretofore or hereafter supplemented or amended) contains a provision for Advance Payments, and in addition if at the time any partial payment is to be made to the Contractor under the provisions of this Partial Payments Article any unliquidated balance of advance payments is outstanding, then notwithstanding any other provision of the Advance Payments Article of this contract the net amount, after appropriate deduction for liquidation of the advance payment, of such partial payment shall be deposited in the special bank account or accounts maintained as required by the provisions of the Advance Payments Article, and shall thereafter be withdrawn only pursuant to such provisions.

(d) The contract was terminable at the convenience of the Government. The contract provided that upon such termination, the contractor should "transfer title and deliver to the Government" all parts, work in process, completed work, supplies and other materials produced or acquired in the performance of the contract, and take such other action as the contracting officer might direct for the preservation or disposition of such property.

5. During the years 1946 to 1949, inclusive, the plaintiff incurred costs and expended money in the performance of Contract 19823 and similar fixed price contracts, such ex-

penditures being made for labor, materials and overhead used and consumed in the manufacturing operation or incorporated into the end product contracted for. The costs chargeable to the performance of a typical fixed price contract include (1) costs of engineering and developmental labor expended in designing and developing the end product, preparing and interpreting engineering documents for use by the manufacturing department, and testing parts and components through wind tunnel operations and flight tests; (2) tooling costs which include the cost of labor and materials expended in the design and coordination of tooling and the production of such tools as jigs, fixtures, tools and dies used in the manufacture of the end product; and (3) production costs which include costs of labor and materials expended in the fabrication of detail parts and minor and major assemblies and the assembly thereof into the completed aircraft or other article. In addition, each of the above categories of labor are charged with a proportionate share of indirect overhead costs. These costs are those which are not charged directly to work in progress as they are incurred. They include administrative salaries and wages and related office expenses, all costs of owning, maintaining and operating a manufacturing plant, the purchasing and storing and handling of all materials necessary to fulfill the contractual requirements, as well as the cost of necessary accounting, personnel management, quality control, contract administration and other services necessary to carrying out the normal functions of the business.

6. Because of the fact that airplane production contracts are by their very nature long-term contracts, and because each aircraft unit is in process of manufacture for a substantial period prior to delivery—in excess of a year in the case of C–97 aircraft—substantial amounts of working capital are required to perform such production. The principal sources of working capital used by plaintiff during the

1946–49 period were partial payments, sometimes also called progress payments, and bank loans, with partial payments being by far the larger amount. The reason why partial payments were used as a source of working capital to a considerably greater extent than bank loans is that unlike bank loans, the Government does not charge interest on partial payments. In addition, interest paid on bank loans is not an allowable item of cost under military contracts, so that providing the required working capital through bank loans would involve a substantial item of cost to the contractor.

The partial payment device was one of the plans in use during the 1945–1950 period to provide necessary funds for contractors in their military work. It was quite usual for the Air Force to pay partial payments to major aircraft manufacturers engaged in the performance of fixed price contracts, and for such payments to provide the greater portion of the funds required to perform the contracts. Partial payments were made because the programs were of such magnitude that not many contractors had the financial resources to operate without financial assistance.

7. (a) Pursuant to the partial payment provisions of its fixed price Government contracts, the plaintiff, from time to time during each of the years 1946 to 1949, inclusive, received partial payments from the Government. The plaintiff, having incurred costs in the performance of such contracts, was entitled to request, and the contracting officer could authorize, a partial payment within the percentage limitation set forth in the contract. The standard procedure of billing for partial payments was for the plaintiff to submit a partial payment invoice periodically to the contracting officer, an Air Force representative stationed at the plaintiff's plant. The contracting officer routed the invoice to the office of the Air Force auditor with an inquiry whether the plaintiff's books of account reflected the costs

which were stated in the invoice as having been incurred. Having satisfied himself that the books did reflect such costs, the Air Force auditor would so advise the contracting officer, the contracting officer would approve the partial payment invoice, and the invoice would then be forwarded to the Army Finance Officer for payment.

(b) Each invoice submitted for a partial payment bore the following certificate signed by a supervisor in plaintiff's Accounting, Records, and Billing Department:

> I certify that the above bill is correct and just; that payment therefor has not been received; that all statutory requirements as to American production and labor standards, and all conditions of purchase applicable to the transaction have been complied with, and that State or local sales taxes are not included in the amounts billed.

8. During the 1946 to 1949 period, there was an Air Force Plant Representative stationed at the plaintiff's plant. The office of the Air Force Plant Representative was divided into five primary functions or departments, one of which was the contracting officer. The other four were production, quality control, property accounting, and flight test. The quality control division maintained surveillance over plaintiff's quality control organization to ensure that the Air Force obtained products conforming to the specifications, and its inspection of the work in process went on at all times. However, such inspection and approval was not made a condition precedent to the approval of partial payment billings, and neither the quality control division nor any other division of the Air Force Plant Representative's office, other than the contracting officer, participated in or had anything to do with the approval of partial payment invoices.

9. Plaintiff's fixed price contracts provided that the amount of partial payments which the contracting officer

could authorize was limited to 90 percent of the cost to the contractor of the property upon which the payment was made. Plaintiff's books of account accumulated costs on the basis of the total contract, and not by aircraft units, and did not permit a segregation of actual costs by units. Accordingly, there was no relationship between the amount of a partial payment invoice and the costs incurred in the production of any particular aircraft unit. Partial payment invoices were based on costs incurred on a particular contract and could be verified from plaintiff's books.

10. The tangible property included in the work-in-process inventories, the title to which was in the Government pursuant to the provisions of the partial payments clause of fixed price Government contracts, was not physically segregated from similar property in the plaintiff's possession in which the Government had no interest. A certain portion of such property was stamped with the model designation of the aircraft type for which it was produced, but such property was not otherwise marked or physically identified to indicate the Government's title.

11. During the years 1946 to 1949, inclusive, and prior and subsequent thereto, the plaintiff regularly maintained fire and extended coverage insurance, with loss payable to the plaintiff, covering all tangible property included in work-in-process inventories, the title to which was in the Government pursuant to the provisions of the partial payments clause of its fixed price Government contracts. The amount of such insurance was not less than the total amount accumulated in the work-in-process inventory, without reduction for any partial payments received with respect thereto.

12. During the years 1946 to 1949, inclusive, the tangible property included in work-in-process inventories, the title to which was in the Government pursuant to the pro-

visions of the partial payments clause of fixed price Government contracts, was not subjected to ad valorem personal property taxes by any state in which such property was physically located.

13. Upon completion of manufacture of each airplane, the plaintiff conducted a flight test program. Thereafter, the Air Force quality control and flight test divisions inspected and tested the airplane, and based on these tests, certified that contract specifications had been met, that the airplane had been flown, and that it operated satisfactorily.

Following the completion by the plaintiff of each aircraft and its delivery to and acceptance by the Air Force, the plaintiff billed the Air Force for the contract unit price. For example, the contract unit price for each B–50 covered by Contract 19823 was $699,671.82, and the plaintiff's billing on delivery was in the same amount. The certificates furnished by the plaintiff and by the quality control and flight test divisions of the Air Force Plant Representative's office accompanied the invoice to the Finance Officer. It was on the basis of those certifications that the Finance Office paid the invoice.

14. Plaintiff's invoice for the full contract unit price of the delivered aircraft was paid partly by check or voucher, and partly by the application or liquidation of a portion of the partial payments previously received from the Government under the particular contract. The Government Finance Officer, upon receipt of the billing, determined the percentage relationship between the amount of unliquidated partial payments theretofore paid to the plaintiff and the contract price of the work remaining to be performed by the plaintiff, including the contract price of the aircraft for which the billing was made. This percentage was then applied by the Finance Officer to the amount of the billing to determine the amount of the partial payments to be liqui-

dated by application against the billing. The plaintiff received from the Finance Officer, in due course following the submission of the billing, a Government check or voucher for a portion of the amount billed, and an attached letter of transmittal setting forth the Finance Officer's computation of the amount of partial payments to be applied against the billing.

For example, on delivery during December 1949 of five B–50D's, the plaintiff sent five invoices to the Finance Officer, each in the amount of $699,671.82, and totaling $3,498,359.10. The Finance Officer determined that the amount of unliquidated partial payments previously paid to plaintiff was 29.6776 percent of the contract price of the work remaining to be performed under the contract, including the work covered by the five invoices. Therefore, 29.6776 percent of $3,498,359.10, or $1,038,229.02, was determined to be the amount of partial payments to be liquidated or applied against the total billing of $3,498,-359.10. Accordingly, plaintiff's billings totaling $3,498,-359.10 were paid to the extent of $1,038,229.02 by application of partial payments previously paid, and the balance by Government check or voucher.

15. The plaintiff's accounting practice, consistently followed during the years 1946 to 1949 and prior and subsequent thereto, was to record in its books of account all partial payments received in an account which plaintiff's General Account Classification classified as a current liability account. This was an acceptable accounting classification account of such payments, although there is no generally accepted accounting practice or principle with respect thereto. All costs chargeable to the performance of a contract were accumulated in a work-in-process inventory account until the aircraft or other article contracted for was delivered. The plaintiff's accounting practice was to record a sale, cost of sale and profit or loss at the time of delivery

of each completed aircraft. The accounting procedures consistently followed by plaintiff with respect to the billing, payment and liquidation of partial payments, and with respect to costs, sales and profits under fixed price contracts, were as follows:

(a) Upon the incurring of costs or spending of money chargeable to the performance of such a contract, the plaintiff debited a work-in-process inventory account and credited the cash or account payable account.

(b) Upon the billing of a partial payment, the plaintiff by journal entry debited accounts receivable with the amount billed, and credited the partial payments account with the same amount. These entries were in due course posted in the plaintiff's General Ledger.

(c) When the partial payment billing was paid by the Air Force, the plaintiff debited to the cash account the amount received, and made an offsetting credit to the accounts receivable account. No entry of any kind was made in the partial payment account by reason of the payment by the Air Force of the partial payment billing.

(d) The accounting entries made following delivery of an aircraft and the billing of the Air Force for the contract price thereof were, first, a debit to accounts receivable for the amount so billed, and a corresponding credit to the sales account. The plaintiff determined the cost chargeable to the production of the aircraft by estimating the total cost of the whole contract and dividing the total estimated cost by the number of aircraft covered by the contract; and the resulting amount was removed from the accumulated costs carried as an asset in the work-in-process inventory account, and was transferred to the cost of sales account by a credit to work-in-process and a debit to cost of sales. The sales and cost of sales accounts were then closed into a profit and loss summary, and the difference between the two, repre-

senting the plaintiff's profit or loss on the sale of the aircraft, was closed into net worth.

(e) Following the submission of its billing for the contract unit price of a delivered aircraft, the plaintiff received a Government check or voucher for a portion of the billing, and a letter of transmittal reflecting the application or liquidation of partial payments in an amount corresponding to the balance of such billing. The account receivable set up when the billing was made was credited to reflect the receipt of cash and the application against such account receivable of the liquidation of certain amounts of partial payments. The amount of partial payments recorded in the partial payments account was reduced or debited by the amount so applied and liquidated.

(f) A period of time from one day to several weeks elapsed between the submission of a bill for a partial payment and payment thereof by the Government. As a result, at various times there were included in the accounts receivable on plaintiff's books amounts representing progress payments on fixed price Government contracts for which bills had been submitted but payment thereof had not yet been made. Three specific instances in which such amounts were included in plaintiff's accounts receivable as of December 31, 1946, 1947, 1948 and 1949, are as follows:

(1) On December 31, 1948, accounts receivable was debited and the progress payment account for Contract 13013 was credited with $60,001.48. Plaintiff received from the Government a payment in this amount on January 12, 1949, on which date cash was debited and accounts receivable credited in this amount.

(2) On December 31, 1948, accounts receivable was debited and the progress payment account for Contract 18821 was credited with $490,771.66. Plaintiff received from the Government a payment in this

amount on January 19, 1949, on which date cash was debited and accounts receivable credited in this amount.

(3) On December 31, 1949, accounts receivable was debited and the progress payment account for Contract 18821 was credited with $125,000.85. Plaintiff received from the Government a payment of $122,850.31 on January 3, 1950, on which date cash was debited and accounts receivable credited in this amount. The difference of $2,150.54 represents interest due the Government on advance payments. On January 3, 1950, an account for interest expense was debited and accounts receivable was credited in the amount of $2,150.54.

There may have been additional amounts included in accounts receivable as of December 31, 1946, 1947, 1948, and 1949, on account of progress payments on fixed price Government contracts for which bills had been submitted but payment thereof had not yet been made. However, certain records of the plaintiff necessary to determine definitely whether there were or were not any such additional amounts were destroyed prior to an attempted determination of this matter for the purposes of this case.

16. (a) On the balance sheets included in plaintiff's annual report to stockholders for the calendar years 1936 through 1942 and 1946 through 1951, partial payments were shown on the asset side as offset to inventories or accumulated charges on contracts with the United States. No progress payments were shown on the balance sheets included in plaintiff's annual report to stockholders for 1943 through 1945. Each report included a certificate by independent certified public accountants to the effect that the balance sheet fairly presented plaintiff's financial position "in accordance with accepted principles of accounting."

(b) Boeing Aircraft Company, a wholly owned subsidiary of plaintiff, was merged into plaintiff as of December

31, 1947. On the balance sheets included in the Federal income and excess profits tax returns filed by Boeing Aircraft Company for the calendar years 1938 through 1943 and 1946, partial payments were shown on the asset side as an offset to inventories. No partial payments were shown on the balance sheets included in the returns filed by Boeing Aircraft Company for 1944 and 1945. Boeing Aircraft Company filed no separate return for 1947, plaintiff having filed a consolidated return for that year.

(c) On the balance sheets included in the Federal income and excess profits tax returns filed by plaintiff for the calendar years 1938 through 1941 and 1947 through 1949, partial payments were shown on the asset side as an offset to inventories or accumulated charges on contracts with the United States. No partial payments were shown on the balance sheets included in plaintiff's returns for 1942 through 1946.

(d) On the balance sheets included in the Federal income and excess profits tax returns filed by plaintiff for the calendar years 1950 and 1951, and in all subsequent returns, partial payments were shown under current liabilities, thus conforming plaintiff's tax return balance sheets to its internal books of account.

17. (a) Plaintiff's Federal income tax return for 1949 was filed on or about May 15, 1950; its return for 1950 was filed on or about November 13, 1951, after passage on January 3, 1951, of the Excess Profits Tax Act of 1950; and its return for 1951 was filed on or about September 15, 1952. On its return for 1950, plaintiff applied for benefits of section 446 of the Internal Revenue Code of 1939 and computed its average base period net income under section 446 in the same manner as it did on its return for 1951. On March 8, 1957, plaintiff filed a claim for refund for 1950 based on the ground that plaintiff's 1950 excess

profits tax should be computed by reference to total assets at the end of the years 1946 to 1949, inclusive, without reduction for progress payments received on fixed price Government contracts. No statutory Notice of Disallowance of said claim for 1950 has been issued.

(b) On the balance sheet included in plaintiff's return for 1949, total assets for the end of the year is shown to be $112,793,771.27. On the balance sheet included in plaintiff's return for 1950, total assets for the beginning of the year is shown to be $156,504,184.51.

18. At the end of each of the years 1946 to 1949, inclusive, the plaintiff's books of account reflected the full amount of costs accumulated in the production of articles which had not been delivered, and the amount of unliquidated partial payments received or for which bills had been rendered, as described in finding 15(f), with respect thereto. Plaintiff's total accumulated costs on fixed price Government contracts, as of December 31, 1946, were $23,216,400; as of December 31, 1947, were $52,477,401; as of December 31, 1948, were $42,844,214; and as of December 31, 1949, were $53,540,263. The unliquidated partial payments received by plaintiff or for which bills had been rendered as described in said finding 15(f), as of December 31, 1946, were $14,923,922.32; as of December 31, 1947, were $40,830,833.12; as of December 31, 1948, were $28,896,208.20; and as of December 31, 1949, were $43,710,413.24.

19. For purposes of determining its excess profits tax liability for the year 1951, plaintiff was a member of a depressed industry subgroup as defined in section 446 of the Internal Revenue Code of 1939. In its U.S. Corporation Income Tax return for the year 1951, plaintiff applied for the benefits of section 446 as required by section 447 of said code, and computed its average base period net income

under said section 446. Such computation required a determination of the amount of total assets held by plaintiff in good faith for the purposes of its business as of the last day of each of the taxable years ended December 31, 1946, 1947, 1948 and 1949, in accord with sections 442 and 446 of the Internal Revenue Code of 1939. In plaintiff's 1951 tax return, the amount of its total assets so held (other than inadmissible assets and loans to members of a controlled group) was stated to be, as of December 31, 1946, $77,650,707.91; as of December 31, 1947, $82,630,335.98; as of December 31, 1948, $128,166,688.57; and as of December 31, 1949, $116,833,763.48.

20. In plaintiff's tax return for the year 1951, the amounts stated therein as constituting plaintiff's total assets for the last day of each of the years 1946 to 1949, inclusive, were in part computed by substracting from plaintiff's total accumulated charges on fixed price Government contracts the amount of the unliquidated partial payments received by plaintiff from the Government, or for which bills had been rendered as described in finding 15(f), all in the amounts set forth in finding 18. If in the determination of plaintiff's total assets under section 446 of the Internal Revenue Code of 1939 the total amount of accumulated charges on fixed price Government contracts are properly includible therein without reduction on account of partial payments received from the Government, or for which bills had been rendered as described in said finding 15(f), plaintiff's total assets as of December 31, 1946, were $90,430,108.63; as of December 31, 1947, were $121,791,207.75; as of December 31, 1948, were $154,894,857.28; and as of December 31, 1949, were $158,695,708.09.

21. All assets held by the plaintiff at any time material to this action were held by it in good faith for purposes of its business.

22. On March 10, 1955, plaintiff duly filed with the District Director of Internal Revenue at Tacoma, Washington, a claim for refund of income and excess profits taxes for the calendar year 1951 in the amount of $1,828,775 or such greater amount as might be legally refundable. One of the reasons asserted for the allowance of said claim and upon which said claim was based was therein stated to be that its 1951 excess profits tax should be computed by reference to total assets at the end of the years 1946 to 1949, inclusive, without reduction for partial payments received on fixed price Government contracts. By letter dated June 28, 1957, plaintiff was given notice by registered mail that said claim for refund was disallowed in full. The date of mailing said letter was less than 2 years prior to the filing of the petition.

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that the plaintiff is not entitled to recover, and the petition is therefore dismissed.

APPENDIX B

Internal Revenue Code of 1939:

SEC. 442. [as added by Sec. 101, Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137, and as amended by Sec. 510, Revenue Act of 1951, c. 521, 65 Stat. 452.] AVERAGE BASE PERIOD NET INCOME—ABNORMALITIES DURING BASE PERIOD.

* * * *

(f) *Total Assets.*—For the purposes of this section, the taxpayer's total assets for any day shall be determined as of the end of such day and shall be an amount equal to the excess of—

(1) the sum of the cash and the property (other than cash, inadmissible assets, and loans to members of a controlled group as defined in section 235(f)(4)) held by the taxpayer in good faith for the purposes of the business, over

(2) the amount of any indebtedness (other than borrowed capital as defined in section 439(b)(1)) to a member of a controlled group (as defined in section 435(g)(6)) which includes the taxpayer.

Such property shall be included in an amount equal to its adjusted basis for determining gain upon sale or exchange, determined under the rules provided in section 441.

* * * *

(26 U.S.C. 1952 ed., Sec. 442.)

SEC. 446. [as added by Sec. 101, Excess Profits Tax Act of 1950, *supra*] AVERAGE BASE PERIOD NET INCOME-DEPRESSED INDUSTRY SUBGROUPS.

(a) *In General.*—If a taxpayer which commenced business on or before the first day of its base period is a member of a depressed industry subgroup, as defined in subsection (c), its average base period net income

determined under this section shall be the amount computed under subsection (b).

(b) *Average Base Period Net Income.*—The average base period net income determined under this section shall be computed as follows:

(1) By determining the amount of the taxpayer's total assets for the last day of each of its taxable years ending after the first day of its base period and prior to the first day of its first taxable year under this subchapter.

(2) By computing the average of the amounts ascertained under paragraph (1).

(3) By multiplying the amount ascertained under paragraph (2) by the adjusted rate of return, proclaimed by the Secretary under subsection (e), for the taxpayer's industry subgroup.

(4) By determining the aggregate amount of interest paid or incurred by the taxpayer for all taxable years ending after the first day of its base period and prior to the first day of its first taxable year under this subchapter, dividing such aggregate by the total number of months in such years and multiplying the quotient by 12.

(5) By subtracting the amount ascertained under paragraph (4) from the amount ascertained under paragraph (3).

* * * *

(26 U.S.C. 1952 ed., Sec. 446.)

Treasury Regulations 130 (1939 Code).

SEC. 40.442-3 [as amended by T.D. 5973, 1953-1 Cum.

Bull. 321, 337]. *Computation of average base period net income.*—

* * * *

(d) *Definitions.*—For the purpose of section 442—

(1) The term "total assets" for any day means the excess, determined as of the end of such day, of—

(i) the sum of the cash and other property (other than inadmissible assets, as defined in section 440(a)(1), and other than loans to members of a controlled group, as defined in section 435 (f)(4) held by the taxpayer in good faith for purposes of the business, over

(ii) the amount of any indebtedness (other than borrowed capital, as defined in section 439 (b)(1)) to a member of a controlled group, as defined in section 435(g)(6), which includes the taxpayer. Property shall be included in an amount equal to its adjusted basis for determining gain upon sale or exchange * * *.

* * * *

SEC. 40.446-3. *Computation.*—

(a) *Average base period net income.*—The computation of the average base period net income under section 446(b) is as follows:

(1) The amount of the taxpayer's total assets for the last day of each taxable year ending after the first day of its base period and prior to July 1, 1950, is determined under section 442(f) and under section 40.442-3(d)(1).

* * * *